

**Draft discussion paper for
Bering Sea and Aleutian Islands crab advisory committee
North Pacific Fishery Management Council
June 2006**

At its March/April 2007 meeting, the Council conducted a review of certain aspects of the Bering Sea and Aleutian Islands crab rationalization program. The review included an examination of both the harvesting and processing share allocations and the arbitration program. Based on that review, the Council stated its intent to create an advisory committee to examine the following:

- 1) the current uses of B shares (those shares exempt from the processing share landing requirements) and whether those uses are consistent with the Council's original intent for the use of B shares, and
- 2) regulatory issues related to administration of the harvest share and processing share allocations and the arbitration program (see Appendix A).

The Council also directed staff to draft this discussion paper to assist the committee and the Council in examining these issues. The paper will be refined as the committee develops specific recommendations for the Council. A draft of the paper, including committee recommendations, will be presented to the Council at its October 2007 meeting.

The paper begins with a brief background section, which describes pertinent portions of the rationalization program. Readers familiar with the program can skip the background section (which is a slight revision of the background in the 18-month review). The paper goes on to describe regulatory issues that the Council could choose to address. The paper concludes with a discussion of the uses of B shares, their consistency with the Council's intent, and potential means to address uses of B shares that are not consistent with that intent.

Background

Under the program, eligible LLP license holders were issued quota shares (QS), which are long term shares, based on their qualifying harvest histories. These QS annually yield individual fishing quota (IFQ), which are privileges to harvest a particular amount of crab in pounds in a given season. The size of each annual IFQ allocation is based on the amount of QS held in relation to the QS pool in the fishery. So, a person holding 1 percent of the QS pool would receive IFQ to harvest 1 percent of the annual TAC in the fishery. Ninety percent of the IFQ are issued as "A shares" or "Class A IFQ," which must be delivered to a processor holding unused individual processor quota (IPQ).¹ The remaining 10 percent of the annual IFQ are issued as "B shares" or "Class B IFQ," which may be delivered to any processor.² Processor quota shares (PQS) are long term shares issued to processors. These PQS yield annual IPQ, which represent a privilege to receive a certain amount of crab harvested with Class A IFQ. IPQ are issued for

¹ Currently, the three percent of the harvest share pool issued to captains as C shares is an exception to this generalization. Those shares are not subject to IPQ landing privileges during the first three years of the program. During that period, the IPQ corresponding to the C share allocations are withheld. The Council is currently considering extending this exemption indefinitely.

² The terms "A share" and "Class A IFQ" are used interchangeably in this paper, as are the terms "B share" and "Class B IFQ".

90 percent of the vessel owner IFQ, creating a one-to-one correspondence between Class A IFQ and IPQ.³

The A share/B share allocation structure has the effect of limiting market choices of participants, since only the 10 percent allocation of B shares are free to be sold to any buyer. Under this structure, the 90 percent A share allocation (with corresponding IPQ) is intended primarily to add stability to the processing sector and provide a means for compensated removal of processing capacity from the fisheries. The 10 percent B share allocation is intended to provide negotiating leverage to harvesters, an opportunity for entry to the processing sector, and a check on the processing market (by providing a negotiated market price)⁴. To aid participants in resolving price disputes, the Council developed a binding arbitration program.

The arbitration system serves several important purposes in the program. It coordinates the matching of A share IFQ held by harvesters with IPQ held by processors. For a 5-day period starting when IFQ and IPQ are issued, shares are matched only by mutual agreement of share holders. After that period has expired, shares may be matched either by agreement or by unilateral commitment of the IFQ holder. Throughout, holders of unused IPQ are required to report the amount of unused shares held to holders of unused IFQ (updating that report within 24 hours of any change). Although this share matching process may aid in establishing commitments to deliver and receive A share IFQ landings, the terms of those transactions may be disputed. The arbitration system defines a procedure intended to assist participants in coming to reasonable terms for those deliveries. If the parties are unable to negotiate a settlement, an arbitration procedure may be used to resolve those terms.

The arbitration process begins with the two sectors (harvesters and processors) jointly selecting a “market analyst” who produces a market report, a “formula arbitrator,” who develops a price formula specifying an ex vessel price as a portion of the first wholesale price, and a pool of “contract arbitrators,” who preside over any binding arbitration proceedings. The market report and formula price are required to be released at least 50 days prior to the season opening. The market analyst and formula arbitrator (who may be the same person) generate the market report and formula price, respectively, based on any relevant information, which may include information received from IFQ holders and IPQ holders. Neither the market report nor the formula price has any binding effect. Instead, they are intended to provide baseline information concerning the market and a signal of a reasonable price.

An IFQ holder that is not able to resolve all terms of delivery with a processor to whom it has committed deliveries may unilaterally initiate an arbitration proceeding. The window for initiating arbitration is 10 days long, beginning 5 days after the allocation of IFQ and IPQ.⁵ The starting point for initiating

³ Although 90 percent of vessel owner IFQ issued each year are issued as A shares, individual allocations can vary from 90 percent. Holders of PQS and their affiliates receive their IFQ allocations exclusively as A shares to the extent of their affiliate’s processor share holdings (i.e., B shares are not allocated for any IFQ that can be matched against affiliated IPQ). The rationale for issuing only A shares to PQS holders and their affiliates is that these persons do not need the extra negotiating leverage derived from B shares. To maintain 10 percent of the IFQ pool as B shares requires that unaffiliated QS holders receive more than 10 percent of their allocation as B shares (and less than 90 percent A shares).

⁴ It should be noted that the limitation on the market resulting from the 90 percent A share/IPQ allocation dampens the market for B share landings by limiting the size of the open market for landings. So, the B share price (while providing an indication of the free market price) may not reflect the price that would exist in the absence of the A share/IPQ allocations.

⁵ As originally developed, this period was intended to begin 25 days prior to the season opening and end 15 days prior to the season opening. This timing was found to be incompatible with the TAC announcement and issuance of IFQ and IPQ, which will typically occur approximately 15 days prior to the season opening in the Bristol Bay red

arbitration coincides with the start of the period during which harvesters may unilaterally commit IFQ to a processor. Once initiated, any holder of IFQ that has committed shares to the IPQ holder may join the arbitration proceeding. This ability to join is critical because the system limits each processor to a single arbitration proceeding. A last opportunity to make use of arbitration is available for harvesters that choose not to join a proceeding. After arbitration is completed, any holder of uncommitted IFQ can bind the IPQ holder to the terms of the proceeding by committing deliveries to the IPQ holder. Binding arbitration proceedings are conducted on a “last best offer” basis. Under this system, each party to the proceeding submits a “last best offer”. The role of the arbiter is to select one offer from each of the two competing offers. Since several harvesters may be involved in a single proceeding, in binding arbitration involving two or more harvesters, each harvester may either submit an independent offer or join a collective offer (as part of an Fishery Collective Marketing Act cooperative). The processor submits a single offer. For each harvester offer, the arbiter’s role is to select either that harvester’s offer or the processor’s offer (which applies to all harvesters).

Since the full effects of the program on the timing of fishing and marketing activities were not predictable, the arbitration system included a flexible component, allowing participants to modify the arbitration timeline. This ‘lengthy season’ approach to arbitration allows IFQ and IPQ holders that have committed deliveries to negotiate a modified schedule for arbitration. If the parties are unable to agree on the lengthy season approach, they may arbitrate whether to adopt that approach and the timing of the proceeding. Agreements to use the length season approach to arbitration must be entered prior to the opening of a fishery.

An important aspect of the arbitration system is the flow of information among the parties. To effectively participate in the program, holders of uncommitted IFQ need timely updates on the availability of unused IPQ, the initiation of arbitration proceedings, and the outcome of arbitration proceedings. Equally (or more) important are the limitations on flow of information, which are intended to prevent potential collusive behavior. Allowing this price and share holdings information, which is necessary for IFQ holders to participate in the system, to flow to IPQ holders could enable some IPQ holders to unfairly leverage their position in the limited landings market.

The arbitration program is administered through a series of contracts among share holders and arbitration organizations, which are formed by share holders in the fisheries. These organizations are responsible for establishing the administrative aspects of the arbitration system, including selecting arbitrators, coordinating the dissemination of information concerning uncommitted shares among the participants, ensuring confidentiality of sensitive information, and collecting payments to disburse program costs. All share holders from both sectors are required to join an arbitration organization.⁶ Separate organizations are required for harvest share holders and processing share holders. Holders of harvest shares that are affiliated with holders of processing shares are required to join an arbitration organization for purposes of facilitating share matching and administration. Due to antitrust concerns, these “affiliated harvesters” are not permitted to join an organization that includes unaffiliated harvesters and are not permitted to use a binding arbitration proceeding to settle terms of delivery.

king crab and Bering Sea *C. opilio* fisheries. To address this inconsistency, the Council amended the program revising the timing of share matching and initiation of arbitration.

⁶ Holders of catcher processor shares are exempt from the requirement of arbitration organization membership, since they are not subject to the processor landing requirements. In addition, C share holders are exempt from the requirement for the first three years of the program, when the processor landing requirements do not apply to C shares.

Under the regulation, harvest share holders and processing share holders jointly select a pool of arbiters to preside over any binding arbitration proceedings. Once a proceeding is initiated, harvesters that are party to the proceeding select an arbiter from the pool to preside over the specific proceeding.

Regulatory Issues

Several administrative complications have arisen under the current rules governing the use of shares, price negotiations, and arbitration. This section of the paper briefly reviews those issues, identifying potential sources of complications, as well as potential solutions.

Elimination of market reports and non-binding formulas for crab fisheries not likely to open

Possible solution: Waive report for a fishery on agreement of the arbitration organizations that the fishery is not likely to open

Issue: Relative timing of closure announcements and season openings – need indication of which fisheries will not open

Under the current regulations, market reports and non-binding formulas are required for each fishery at least 50 days prior to the season opening. The issuance of these reports is slightly complicated by the uncertainty concerning whether reports are required for fisheries unlikely to open (see 50 CFR 680.20(f)(1) and (g)(1)). No provision is made to exempt fisheries unlikely to open from the requirement for a market report and non-binding formula. Development of a process to omit this requirement for fisheries unlikely to open would simplify administration of the program for participants.

Annual surveys are completed in the late summer. Information from these surveys is incorporated into the stock assessments prior to TAC setting. As a result, a determination of whether to open a fishery is often not made until late September in most fisheries⁷ – only a few weeks before the fishery opening. Providing a meaningful exemption requires an earlier determination, since the reports are due in late August from most fisheries. The industry (through the arbitration organizations) could likely come to agreement on which fisheries are unlikely to open (for which market reports and non-binding formula could be waived). The annual SAFE contains substantial information concerning recruitment and future year classes that could be used by the arbitration organizations to determine which fisheries are unlikely to open. The arbitration organizations, in essence, followed this process in the first two years of the program by not contracting reports for the St. Matthews blue king crab, Pribilof red and blue king crab, and Western Aleutian Islands red king crab fisheries.

If the arbitration organizations agreed not to contract a report for a fishery and the State later decided to open that fishery, the market report and non-binding formula could be required to be prepared within a specified time of the announcement. The feasibility of such an arrangement should be explored with the current arbitration organizations, market analysts, and formula arbitrators, since the arrangement would need to be specified in their contracts. In addition, preparation of reports on short notice could require some preliminary work on the part of the market analyst and formula arbitrator, particularly for fisheries for which no market reports or non-binding formulas have been prepared in the past (i.e., the Western Aleutian Islands red king crab, Pribilof red and blue king crab and the St. Matthew blue king crab fisheries). In fisheries that have been open since implementation of the program, the annual market reports and non-binding formulas are effectively supplemented versions of reports from preceding years. In fisheries that have not been open, preparation of a report from scratch could require substantially more

⁷ Currently, the exceptions are the golden king crab fisheries, for which TACs are set in late July or early August.

work than development of an annual report that relies in part on work from preceding years.

Staleness of market reports

Possible solutions: Provide for supplements

Eliminate market report requirement (through program amendment)

Simplify market report through contractual arrangement with the market analyst (effectively eliminating the requirement without a program amendment)

Develop a market report supplement with publicly available information

Change timeline to allow for release of market report at a later time

Develop substitute for market report using net posting of publicly available information

Issue: Antitrust implications of the use of data except those available from public sources

The market analyst is required to prepare the market report for a fishery at least 50 days prior to the opening of the season. Given this timing, the report is approximately 2 months old by the time of the first delivery in a fishery. Furthermore, any price information contained in the report is required to be at least 3 months old at the time of release. Consequently, that information in the market report is at least 5 months older than the landings that it is intended to apply to. Because of the timing of the report and the limitations on information it may contain, most participants in the fisheries believe that the information in the reports is stale by the time it would be useful for negotiations. The usefulness of the report is certainly questionable in the case of the Bering Sea *C. opilio* fishery. Although the fishery opens in October, simultaneously with the opening of the Bristol Bay red king crab fishery, participants have elected not to fish until after January 1st, when the fishery was traditionally prosecuted under the License Limitation Program (LLP). By the time of fishing begins, the market report itself is at least four months old, while the information it contains is at least seven months old.

Staleness of the market report could be addressed in a few different ways. One option is to simply dispose of the market report requirement. Dispensing with the market report requirement through a program amendment could be appropriate, if participants are able to gather adequate market information through other means and a common, unbiased source of market information is not useful for negotiations. In considering this issue, it should be borne in mind that processors and harvesters could be in different positions. While the Inter-Cooperative Exchange has overcome some of this difference, non-members of that cooperative may have less (or more costly access to market information). In addition, the contentious price negotiations in the crab fisheries in recent years, suggest that an unbiased source of market information may be beneficial to price negotiations.

Alternatively, the arbitration organizations could choose to minimize the market report requirement in the contract with the market analyst/formula arbitrator. Through the terms of the contract, the organizations could minimally satisfy the requirements for a market report contained in the regulations at minimal cost (see 80 CFR 680.20(f)), since the person preparing the report would also be preparing the price formula report. The downside of using a contract amendment for to provide a minimally sufficient market report is that it could be contentious, if parties cannot agree on the scope of the report.

If the Council believes that the market report provides useful information to participants, it could amend the market report requirements to improve the timeliness information in the report. This could be accomplished by changing the nature of the information contained in the report. Currently, reports are limited to historical information to prevent the distribution of market data that could be used in an anticompetitive manner (see Arnold & Porter, 21-22). If the report utilizes only publicly available information, the report would pose no such risk. Two different approaches could be used to address this

shortcoming. One would be to allow a timely supplement to the market report. Allowing this supplement would likely require a regulation change, since the current regulation prohibits interim or additional reports or supplements (see 80 CFR 680.20(f)(2)(vii) and (viii)). The supplement could be authorized, provided that only publicly available information is permitted to be contained the report. The use of a supplement would allow participants to be updated on information midseason, as would likely be necessary to receive pertinent and timely information concerning market conditions for the Bering Sea *C. opilio* fishery.

Alternatively, the timeline for the report could be modified, so that the report is issued at a later time. This second approach, however, has pitfalls. Postponing the report in its entirety could increase the costs, since to date the report has been integrated with the formula price report. Combining the reports in a single package also provides a comprehensive analysis of market conditions and the price that would be generated by those conditions under the arbitration standard. This integrated package is likely of greater use to participants than two separate reports. One way to maintain the integrated package would be to delay the price formula report. Delaying that formula, however, could limit its usefulness in negotiations, which already are subject to time pressures under the schedule for share matching and initiation of arbitration. If the Council believes that this problem should be addressed, its choice of solutions should be based on preferences of the participants, who derive any benefit of the market report in their negotiations.

Another approach to providing market information to participants, suggested by the harvester arbitration organization, would be to simply make available up to date, publicly available market information to participants in both sectors from a common source. The source would not analyze markets or make any projections, but would only provide information on current market conditions. The specific sources from which information would be drawn could be agreed by the arbitration organizations.

In considering a solution that eliminates market reports (or at least the analytical aspects of the reports), the potential to disadvantage fishermen with less knowledge of crab markets should be considered. Participants with less understanding of markets are likely to derive the most benefit from the market report.

Timing of market report for golden king crab to allow for most recent season's data

Possible solutions:

Change timeline to allow for release of market report at a later time

Issue: Antitrust implications of the use of data except those available from public sources

Under the current schedule for market reports, the market report for the Aleutian Islands golden king crab fisheries is required to be finalized 50 days prior the season opening (50 CFR 680.20(f)(4)(i)). Since the golden king crab fisheries open in mid-August, the reports are due in late June. At this time, data from the prior season are typically not fully compiled. A slight delay in the delivery of this report, such as requiring the report to be delivered 30 days prior to the season, could accommodate the inclusion of more complete information from the previous season. Refining the timing of the golden king crab market report release could assist participants in addressing problems with the staleness of market reports in general. Depending on the change in timing of the report, the contents of the report may need to be revised to prevent its potential use for anticompetitive behavior. Any data used in the report that is less than three months old should be from a public source.

Compressed time for share matching and initiation of arbitration

Possible solutions: Delay opening of the C. opilio and Western C. bairdi fisheries

Extended time period for share matching and negotiation

Issue: Extension of time periods could affect negotiating leverage

A critical aspect of the Class A IFQ/IPQ system is the process by which shares are matched and binding arbitration proceedings are initiated. The one-to-one relationship between A shares and IPQ raises the importance of making available information concerning uncommitted shares and establishing an efficient system for matching those shares and initiating arbitration, in the event a negotiated settlement of delivery terms cannot be reached. This section describes the operation of the system for matching shares and initiating arbitration under the program.

The system of negotiated and unilaterally matching shares is intended to facilitate the orderly commitment of Class A IFQ deliveries to processors holding IPQ. Coordinated with share matching is the process for initiating a binding arbitration proceeding. The regulatory process for matching Class A IFQ to IPQ begins on the issuance of those shares. For the first 5 days after shares are received, holders of Class A IFQ can, by negotiated agreement, commit their shares to holders of unused IPQ. A commitment need not settle all terms of delivery, but prevents either share holder from committing their shares to a different person. After this period of negotiated commitments, holders of Class A IFQ may unilaterally commit their shares to the holder of uncommitted IPQ. In addition, at any time during the first 10 days after the period of negotiated commitments, a holder of Class A IFQ that has committed those shares to an IPQ holder may unilaterally initiate an arbitration proceeding to settle outstanding terms of delivery.⁸ Alternatively, the parties may agree to take a 'lengthy season approach' to arbitration, under which any arbitration proceeding is delayed until a specific time during the season.⁹ The lengthy season approach must be adopted prior to the season opening (which under the current timelines for some fisheries occurs prior to the end of the period for initiating arbitration). By the end of the 10-day period, if a holder of Class A IFQ has not either initiated a proceeding or adopted the 'lengthy season approach,' the ability to access the arbitration system is effectively forfeited.

Several issues have arisen because of the compact time period during which shares must be matched and arbitration actions initiated. Table 1 shows the timing of various aspects of share matching and arbitration in the fisheries in the second year of the program. The table shows the compressed time frame under which share holders are required to either negotiate terms of deliveries or arbitrate those terms. Under the standard arbitration timeline, harvesters and processors were compelled to match shares and either settle terms of delivery for those landings or commence arbitration for all Class A IFQ and IPQ in the two primary fisheries (the Bristol Bay red king crab and Bering Sea *C. opilio* fisheries) and one small secondary fishery (the Western Bering Sea *C. bairdi* fishery).¹⁰ In considering these time pressures, it should be borne in mind that most of the fishing and processing activity in the Bristol Bay red king crab has occurred in late October and November. So, not only must participants concern themselves with share matching and negotiations, but they also must prepare facilities, vessels, gear, processing lines and position vessels and crews for that fishery. It should also be considered that two minor fisheries (the St.

⁸ It should be noted that this structure, under which a harvester may unilaterally commit deliveries and initiate arbitration, effectively allow a Class A IFQ holder to compel an IPQ holder to accept deliveries at the arbitrated price. IPQ holders have no to power to compel an IFQ holder to commit to deliveries, in the absence of that commitment by a harvester.

⁹ It should be noted that, if the processor does not agree to the 'lengthy season approach,' a harvester may arbitrate that issue.

¹⁰ Bering Sea *C. bairdi* fishery is divided into two fisheries, one east of 166° W longitude (the Eastern Bering Sea *C. bairdi* fishery) and one west of 166° W longitude (the Western Bering Sea *C. bairdi* fishery).

Matthews blue king crab and the Pribilof red and blue king crab fisheries) have not been open since the program was implemented. If these fisheries were to open, their TAC announcements and IFQ/IPQ issuance would coincide with the TAC announcement and share issuances in the Bristol Bay red king crab and Bering Sea *C. opilio* fisheries, adding further time pressures to share holders wishing to rely on the arbitration system.

Table 1. Critical dates for share matching and arbitration (2006-2007).

2006-2007

Fishery	Due Date for Market Report and Price Formula	TAC Announcement	IFQ/IPQ Issuance/Start - negotiated commitment period	End - negotiated commitments/Start - unilateral IFQ commitments/Start - initiation of arbitration actions	Season opening - End - period to agree to lengthy season approach	End - arbitration initiation period
Bristol Bay red king crab	August 26	September 29	October 6	October 11	October 15	October 21
Bering Sea <i>C. opilio</i>	August 26	September 29	October 6	October 11	October 15	October 21
Eastern Bering Sea <i>C. bairdi</i>	August 26	September 29	October 6	October 11	October 15	October 21
Western Bering Sea <i>C. bairdi</i>	August 26	September 29	October 6	October 11	October 15	October 21
Aleutian Islands golden king crab	June 26	July 18	August 6	August 11	August 15	August 21

The timeline for share matching and arbitration was initially keyed off the season opening. Recognizing the necessity of share matching and the importance of market timing, the workgroup that developed the arbitration system sought to have a system that would have delivery terms (including prices) decided prior to or early in the season. To meet that objective, the system needed to include share matching, negotiation, and the initiation of arbitration all in the preseason. The starting point for share matching and negotiations is, by necessity, the issuance of IFQ and IPQ. Without the IFQ and IPQ issuance, parties are unable to match shares.¹¹ Since the IFQ and IPQ issuance cannot be made without the TAC, the TAC announcement constrains the time for share matching and negotiations. The simplest (but likely infeasible) means to relieve the time pressure would be to make TAC announcements earlier, allowing for earlier issuance of IFQ and IPQ. This would allow the periods for negotiation, share commitment, and arbitration initiation to be extended back from the seasoning opening. However, TAC announcements likely cannot be made sufficiently earlier than their current dates. Annual stock surveys are conducted in the late summer of each year. Under the current schedule, analysts who produce stock assessments and TACs have little time to complete modeling needed for the fall fisheries. Given the timing of the survey and the need to complete models based on the most recent survey data, earlier TAC announcements are not feasible. A few other means of accommodating the need for additional time for negotiations are possible.

One way to alleviate some of the time pressure would be to move back the season opening for the Bering Sea *C. opilio* and the Western Bering Sea *C. bairdi* fisheries, which is prosecuted, in part, incidentally to the Bering Sea *C. opilio* fishery. Delaying this opening (and the timing of the associated negotiating,

¹¹ Class B IFQ are issued only to QS holders that have no affiliation with an IPQ holder, to ensure that the negotiating leverage realized through those shares, which are free to be delivered to any processors, is realized by independent share holders. Affiliation is determined on an annual basis, to ensure that up to date ownership information is used for assessing affiliations. Since the total Class B IFQ issuance is 10 percent of the IFQ pool on an annual basis, the specific portion of each QS holder's allocation that will be Class B IFQ is not known with certainty until IFQ are issued. So, participants that wish to pre-plan their share matches cannot do so with certainty until IFQ are issued.

share matching, and arbitration periods) would allow participants to concentrate on the negotiations related to the Bristol Bay red king crab and Eastern Bering Sea *C. bairdi* fisheries, which is prosecuted, in part, incidentally to the Bristol Bay red king crab fishery. This delay would allow participants to complete share matching and negotiations for Bristol Bay red king crab and Eastern Bering Sea *C. bairdi* prior to feeling the pressure to match shares or settle terms for Bering Sea *C. opilio* and Western Bering Sea *C. bairdi*.¹² Addressing the time constraints under this approach would require cooperation of state and federal managers. State managers would need to modify the current season opening dates for Bering Sea *C. opilio* and Western Bering Sea *C. bairdi*. The Council would need to modify the timeline for share matching and arbitration for the Bering Sea *C. opilio* and Western Bering Sea *C. bairdi* fisheries to extend those periods. Under the current regulation, share matching by agreement takes place in a 5-day period, while unilateral share matching by harvesters and initiation of arbitration both take place in a 10-day period. Coordination between state and federal regulators will be important to ensure that the modification of rules achieves the intended goal of extending these negotiation and arbitration periods.¹³

The movement of season openings for Bering Sea *C. opilio* and Western Bering Sea *C. bairdi* would relieve some time pressures. Whether moving just those openings would be sufficient could be questioned. In recent years, the St. Matthews blue king crab and the Pribilof red and blue king crab fisheries have been closed. If those fisheries were to reopen, their season openings would also coincide with the October 15 openings of the Bristol Bay red king crab, Bering Sea *C. opilio* and Bering Sea *C. bairdi* fisheries.

Another method that would extend the time for negotiation and initiating arbitration would be for federal managers to simply extend the time periods from their current lengths. Extending the relatively short period for negotiations and initiating arbitration proceedings would address the problem of limited time to resolve share matching and delivery negotiations. The extension of the period into the fishing season could affect negotiating leverage between the parties. Much of the fishing in the Bristol Bay red king crab fishery is timed to allow catch from that fishery to be delivered to seasonal markets in Japan. Creating a timetable for share matching and arbitration that allows parties to delay activities in the fisheries to a point that limits access to the seasonal markets could enable one side to exert pressure on the other. The extension of the time period for the Bering Sea *C. opilio* and Western Bering Sea *C. bairdi* fisheries could relieve some of the time pressures caused by needing to negotiate landings for several fisheries simultaneously. In addition, since those fisheries are typically prosecuted after the New Year, the ability of participants to exert negotiating pressure by delaying negotiations into the season is minimal.

Extending the time for initiating arbitration could also affect the interests of the parties in several ways. Under the current arbitration system, each processor is limited to a single arbitration proceeding in each season. Whether extending the timeline for arbitration initiation would affect this aspect of the program should be clarified. Allowing multiple proceedings with each processor as a part of the extension could greatly affect their interests, as the arbitration proceedings can be costly to all participants and are a distraction from other business.

¹² To some degree, participants have relieved the time constraint by using the 'lengthy season approach' to arbitration in the Bering Sea *C. opilio* and Western Bering Sea *C. bairdi* fisheries. This addresses the problem only partially, since resorting to that approach requires the commitment of shares under the share matching system.

¹³ As an interim measure, the state could delay the season opening for Bering Sea *C. opilio* and Western Bering Sea *C. bairdi* fisheries and NOAA Fisheries could delay the issuance of IFQ and IPQ. Since the negotiating and arbitration periods are timed from the issuance of IFQ and IPQ, delaying these issuances and the season opening would allow participants to finish their negotiations and arbitration proceedings for Bristol Bay red king crab prior to needing to engage in negotiations for Bering Sea *C. opilio* landings.

Liability of arbitrators, market analysts, arbitration organizations, and third party data providers

Possible solution: Grant of immunity

Both arbitration organizations have suggested that it is appropriate to preclude lawsuits against arbitration organizations, the third party data provider (who manages notices required to be given under the system), and all market analysts and arbitrators. Such immunity is typically provided to arbitration organizations that administer arbitration proceedings and arbitrators. Arbitrators, in turn, are typically required to abide by ethical standards similar to those applicable to judges.

Provision of previous year's arbitration outcomes to the formula arbitrator

Possible solution: Provide for arbitration organizations to deliver outcomes to the formula arbitrator

Under the arbitration system, the formula arbitrator is required to consider the 'highest arbitrated price' from the previous year's binding arbitration proceedings when developing the price formula. In the first year of the program, the formula arbitrator received the parties' last best offers and the contract arbitrator's decision, which simply identified the winning offer. These documents alone provide the formula arbitrator with little information with which to discern the justification for the decision. To enable the formula arbitrator to put reasonable and appropriate weight on the decision, the formula arbitrator likely requires additional information concerning the proceedings. To address this shortcoming, NOAA Fisheries has agreed to provide the formula arbitrator with the arbitration submittals of the parties and the arbitrator's decision. The submittals contain all supporting arguments advanced by the participants and should enable the formula arbitrator to understand the terms at issue and the circumstances surrounding the dispute, compare the two offers, and understand the arguments advanced by the parties in support of those arguments. Providing the formula arbitrator with this information has the advantage of adding a check on the contract arbitration process, putting that decision in context to ensure that it is given appropriate weight (in light of the broader standard) in the following year's formula.

NOAA Fisheries has suggested that administrative complexity could be reduced if the formula arbitrator is provided the arbitration submittals and the arbitrator's decision by the arbitration organizations. Revising the rule to allow for this transmission of information would be a relatively straightforward amendment to the program, provided the change is agreeable to participants in the fisheries and the arbitration organizations.

The B Share Allocation

The Council has requested that the committee also examine the uses of B shares. This aspect of the committee's work should examine the current uses of B shares, in comparison to the uses intended by the Council, and barriers to B shares serving their intended uses. Ultimately, the committee should attempt to identify potential methods of ensure that B shares best serve their intended purposes.

Intended Uses of B shares

Serve a competitive market

Flow to neglected product markets

Facilitate processor entry

The 10 percent annual allocation of B share IFQ is "free" to be landed with any processor. The Council intended these "free" shares to serve a few purposes. First, the allocation provides some degree of competition, which might otherwise be lacking under a system in which harvesters are compelled to land

catch with processors holding IPQ. Second, by allowing B shares to flow to their most valuable use, the allocation was thought to provide a check on the market, in the event that IPQ holders were not aggressively pursuing market opportunities for their products. A third use of B shares could be to facilitate processor entry (NPFMC/NMFS, 2004a).

To help ensure these intended benefits are realized, B shares are allocated to each harvester only to the extent that the harvester is independent of processor affiliation.¹⁴ Allocating shares to independent harvesters facilitates competition for landings that would be lacking for shares held by harvesters with affiliations to IPQ holders, who might be inclined to supplement their IPQ landings with B share landings. Providing B share allocations only to independent harvesters also could assist B shares in serving the Council's purpose of providing a check on market opportunities. If market opportunities are being neglected by IPQ holders, harvesters independent of IPQ holders might pursue those opportunities. Lastly, affiliates of IPQ holders are unlikely to solicit entry of competitors, so allocation of B shares to independent harvesters might increase the potential for entry.

Assessing the extent to which B shares are serving any of these purposes is confounding for a few reasons. First, the program has been in place only two full seasons. Given the short tenure of the program and its complexity, a period of adjustment is likely prior to any program aspect achieves its full effect. Furthermore, the nature of the fisheries, its markets, and the program also present a challenge for assessing these aspects of the program. Since A share landing prices are based in large part on historic prices obtained in a competitive market, small differences between A price and B share prices may not always suggest that B share landings are not subject to competition. In addition, since delivery terms influence price, price differences, in and of themselves, may not reveal the extent of competition.

Possible unintended (and conflicting) uses of B shares

Logistics and coordination of landings

Deadloss

Approaching the issue from the other side helps clarify issues concerning B share use. In other words, ensuring that the existing B share pool best serves its intended purposes might be accomplished by limiting the extent to which B shares are needed to serve other purposes. Generally, the three intended uses of B share all arise from B share holders having choice concerning their use and sale. The first intended use of B shares is simply that those shares be available to be competitively marketed. Allowing harvesters the flexibility to determine the market for these shares serves this purpose. The second purpose is to ensure that reasonable market opportunities are pursued, if neglected by IPQ holders. Again, ensuring B share holders are able to freely use of their shares will maximize the opportunity for those shares to pursue underserved, valuable markets. Third, B shares are intended to provide for processor entry. Ensuring B share users are not constrained in their use of those shares will maximize the extent to which B shares provide processor entry opportunities. So, by considering the extent to which B shares are needed to serve other purposes, we can assess whether they are being used as intended.

¹⁴ Affiliation under the regulation exists in the case of either functional control of the QS holder or common ownership in excess of 10 percent (50 CFR 680.2). A harvester with a processor affiliation would receive its allocation of IFQ as A shares to the extent of affiliated processor share holdings. So, a harvester that holds 1 percent of the QS in a fishery that is affiliated with a processor that holds one-half of one percent of the processor share pool would receive Class A IFQ to match against for one-half of one percent of the IPQ pool. The remainder of the harvester's IFQ allocation would be subject to the A share/B share split. Harvesters with no processor affiliation receive their full allocations subject to the A share/B share split.

Two obstacles that could be preventing B shares from being used for their intended purposes have been identified to date. First, many harvesters have asserted that B shares cannot be freely marketed (at least not for the entire season) because they believe the shares need to be reserved for logistical purposes. In the Bering Sea *C. opilio* fishery, ice and a processor fire complicated North deliveries for portions of the first two seasons. Regional and processor share delivery requirements on A shares limit the ability of harvester to respond to midseason contingencies affecting deliveries. For example, harvesters fishing a portion of their allocation that would be used for a North A share delivery will need commensurate South A share holdings to shift the deliveries to the South. Furthermore, reconciling the need for flexibility of delivery relationships under a system that is intended to ensure that all A shares and IPQ are committed in the preseason presents a challenge. With all A shares and IPQ fully committed in the preseason only systems that pool a relatively large amount of share holdings from both sectors are likely to successfully accomplish the coordination needed for these changes in commitments. On the harvest side, the ability of participants to organize standdowns (or strikes) suggests some ability to coordinate fishing across the fleet. Whether this ability can extend to coordinating changes in the timing of deliveries across several cooperatives and processors is not known. Organization of deliveries at this much more specific level is likely to be substantially more challenging. Making changes in prescheduled deliveries midseason poses even greater challenges. Extending the coordination to the processing sector may present less of a logistical challenge, but may suffer from other impediments. Process should be careful to coordinate their activities. Antitrust laws may complicate the coordination of deliveries midseason among multiple processors.

Assessing any midseason delivery rescheduling is challenging because of the production efficiency effects on the different participants. Almost all midseason rescheduling will have a cost for the participants making those adjustments. Fairly distributing these costs across participants is likely to draw some controversy. Processors have attempted to schedule deliveries (for production efficiency benefits and to serve specific markets) by discounting prices after a certain date. Rescheduling can disrupt these preseason arrangements for both sectors.

A second unintended use of B shares has been to cover deadloss in landings. This practice seems to have been adopted for some landings in the first year of the program. Whether this practice has persisted is not certain. The use of shares for deadloss should be specified in contracts prior to the season. In addition, the arbitration standard specifies that the arbitrator may consider deadloss in an arbitration finding. The inclusion of deadloss as a consideration in arbitration should allow an arbitrator to accommodate reasonable deadloss in an arbitration finding, limiting the necessity for B shares to be used for deadloss on a landing that is otherwise disproportionately an A share landing.

APPENDIX A

C-4(a) Crab Rationalization 18 month review

Draft Council Motion

April 2, 2007

The Council directs staff to draft a discussion paper analyzing how B shares are being used and whether their uses are consistent with the original intent. A draft of this paper will be prepared by June 2007, for discussions by a BSAI crab advisory committee (see below) and a final draft will be presented to the Council in October 2007.

The Council requests a staff analysis to allow C shares to remain open-access shares, without regional designation and A and B share splits. Analysis needs to be initiated now, or the C shares will defacto become designated to the regions and the 90/10 A/B split will occur automatically at the three year anniversary of the program's implementation. Also, include options in the analysis for extension of the three year sunset date on leasing of C shares and present it at the June meeting.

Additionally, staff is requested to provide a discussion paper in October 2007 concerning legal immunity for the arbitration organizations, arbitrators, and market analysts.

The Council shall appoint a BSAI crab advisory committee to address the draft discussion paper on B shares (see above) and the regulatory issues identified in the 18 month review. The committee will work with staff to make recommendations to the Council in October 2007 on issues such as the elimination of market reports for crab fisheries not likely to open in a given year, to change the 50 day market report requirement for golden king crab to 30 days, to allow timely supplements to the market reports, alternatives to extend the time periods for share matching, and other relevant issues.